

**INTERPRETIVE LETTER 87-4 (APRIL 9, 1987)**

**State bank may not sell participation in credit card receivables to its affiliated state bank because past due accounts included in portfolio are low quality assets and proposed transaction is not a true participation.**

This letter is to confirm the position of the Illinois Commissioner of Banks and Trust Companies ("Commissioner) regarding a state bank's proposal to sell participations of its VISA loan portfolio to \* [state bank #2], an affiliate. Because the portfolio consists of revolving credit accounts, a certain percentage of delinquencies consistently occur. It is economically infeasible for the bank to separate, for purposes of the participation agreement, the delinquent accounts from the accounts in good standing. As a result, the portion of the portfolio participated out to \* [state bank #2] may contain some delinquencies.

Section 35.2 of the Act sets forth certain limitations on transactions between a state bank and its affiliates. Under Section 35.2(b)(1)(C)(i), \* [state bank #2] is an affiliate of the state bank because \* [state bank #2] is controlled by the individuals who control the state bank. Section 35.2(a)(3) expressly prohibits the purchase of a low quality asset by a state bank from an affiliate. Low quality assets are defined in Section 35.2(b)(10)(C) to include assets on which principal or interest payments are more than 30 days past due.

In the situation at hand, the participation agreement indirectly provides for the purchase of low quality assets by an affiliate since the portfolio of loans purchased contains some delinquent accounts. Therefore, such a transaction is prohibited under Section 35.2(a)(3) of the Act.

In addition, the proposed participation agreement does not appear to constitute a true participation. Generally, a loan participation is deemed to be a true participation if there is a pro rata sharing of market risk and credit risk between the seller and the buyer. Section 5 of the proposed participation agreement provides that the "Buyer's exposure to participation and losses shall only arise to the extent that charge-offs are incurred at a rate in excess of the now present rate of .35% of outstandings." Since the affiliate's credit risk is initially limited, there is not a pro rata sharing of this risk. As a result, this Agency would not deem the proposed participation agreement to be a true participation.

**[NOTE: Subject to federal regulatory approval, there may be some instances in which a bank may dividend its low quality assets to the parent holding company, which may then make a capital contribution of those assets to the affiliated bank.]**